



Association pour la participation des
entreprises françaises à l'harmonisation
comptable internationale



A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
London EC4M 6XH
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Paris, July 23, 2010

Re: *Discussion Paper Extractive Activities*

We welcome the opportunity to comment on the IASB staff's Discussion Paper dealing with Extractive Activities (the DP).

We have the following principal comments on the DP:

- We are not convinced that a single separate accounting standard is required for the extractive industries. We recognise, however, that IFRS 6 does not achieve comparability between entities and therefore we would be in favour of the development of an interpretation of IFRS, in particular IAS 38 and IAS 36, taking into account some of the specific issues faced by the upstream minerals and oil and gas industries.
- Any proposals for these industries should maintain a principles-based approach within the Framework and existing IFRS, with additional interpretative guidance specific to the industries.
- Any project on this topic must be a joint project with the FASB and should look closely at the suitability of existing US requirements in this area as a starting-point.
- We do not agree with the asset-continuum approach based on the initial recognition of a licence and capitalisation of all subsequent expenditure as an enhancement to it.
- Fair value is an unsuitable measurement basis for mineral and oil and gas reserves. A fair value in this context is based upon a series of assumptions which lead, in our view, to a value which is not sufficiently reliable to be recognised in principal financial statements. Furthermore, the process required to arrive at such an estimated value would be extremely onerous and we do not believe that users require this.

- We are opposed to disclosures of reserves in terms of current or fair value, on the same grounds as in the previous point.
- We are strongly opposed to the incorporation of the requirements of non-governmental organisations in accounting standards. IFRS should observe the objective of general financial statements as described in the Framework. Any disclosures of the type required by Publish What You Pay (PWYP) and other similar organisations should be imposed only by governments or regulators, who are better placed to deal with the commercial and other consequences of such disclosures.
- We disagree strongly with any specific sectors of economic activity being singled out for the imposition of what we think are excessive and onerous disclosure requirements. The appropriateness of all disclosures, including these, should be considered in the context of a comprehensive disclosure standard which would lay out clear principles for disclosure requirements.

In addition to these principal comments, answers to the detailed questions contained in the invitation for comment are provided in the appendix.

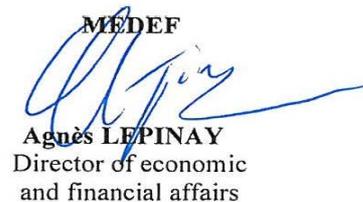
Should you require any supplementary comments or explanations, please do not hesitate to contact us.

ACTEO

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Appendix to our letter on the IASB Discussion Paper on Extractive Industries

ACTEO's response to the questions asked in the DP

Question 1 – Scope of extractive industries

In Chapter 1 the project team proposes that the scope of an extractive activities IFRS should include only upstream activities for minerals, oil and natural gas. Do you agree? Are there other similar activities that should also fall within the scope of an IFRS for extractive activities? If so, please explain what other activities should be included within its scope and why.

We note that the activities covered by the DP are broader than those in the scope of IFRS 6 Exploration for and Evaluation of Mineral Resources, while the range of industries dealt with is more restricted than those of IFRS 6. We agree with this scope on the grounds that the Oil and Gas and Minerals industries have similar activities and face similar risks. If this project goes ahead on the basis of this scope, then the question will arise as to how to cater for those industries currently within the scope of IFRS 6 which will fall out of scope.

Our major concern with the scope is that we are not sure whether there is a valid conceptual justification for an industry-specific standard for the Oil and Gas and Minerals industries while other industries with some of the same accounting issues, such as research and development costs in the pharmaceutical industry, will not have a specific standard.

Finally, we are not aware of many issues of interpretation of existing IFRS having been raised and thus wonder whether an IFRS is required. In general, we think that entities have arrived at satisfactory approaches to accounting for most items in the exploration and production phases under current IFRS, and in particular IFRS 6 allows a wide range of accounting treatments. There are some areas where there are specific difficulties such as Production Sharing Agreements/Contracts (PSA's/PSC's), farm-ins and farm-outs, swaps of recognisable assets for example, exploration licences) for expensed elements (for example, seismic data) and stripping costs. These matters might be dealt with more efficiently by means of Interpretations, as is the case for the latter.

Question 2 - Approach

Also in Chapter 1, the project team proposes that there should be a single accounting and disclosure model that applies to extractive activities in both the minerals industry and the oil and gas industry. Do you agree? If not, what requirements should be different for each industry and what is your justification for differentiating between the two industries?

We are not sure that the DP provides sufficient evidence for one to conclude that the two industries are sufficiently similar for one detailed accounting model to be applied to both. On the other hand, it appears to that both industries have applied the current IFRS standards to their activities in a satisfactory way.

This leads us to the conclusion that a more robust rationale for the development of a specific accounting model must be provided before we could support such a project.

IFRS 6 provided a means to avoid having to examine closely and critically the application of IAS 38 and IAS 36 to the exploration and evaluation phase of upstream activities. We believe that these industries could arrive at satisfactory accounting outcomes which would not be very different from those achieved today if they applied IAS 38 and IAS 36, perhaps with minor amendments. We therefore suggest the alternative approach to this project of identifying the specific instances where these two existing standards appear to prevent appropriate accounting treatment for these industries and propose specific amendments to the generic standards which would resolve these difficulties, while remaining within the Framework. We think it is important to maintain a principles-based approach to IFRS and to avoid exceptions as far as possible.

As stated above, we are not sure that a single specific accounting standard for the extractive industries should be developed and are not convinced that specific separate standards are required for these industries. If the Board decides to pursue a project to develop a standard then we think it would be essential to look closely at US GAAP. Current US GAAP provides extensive guidance to the Oil and Gas industry. It is also widely used as a source in determining accounting policies under IFRS where there is no specific IFRS guidance and US GAAP does not conflict with IFRS. In addition, the US Securities Exchange Commission (SEC) has developed regulations for accounting and disclosure which are used by Oil and Gas entities which have to file financial statements in the USA. These US rules are accepted throughout this industry across the world, and have become de facto the prevailing accounting and disclosure guidance. If an industry-specific accounting standard for is to be developed, then in our view:

- a) Any project on the accounting and disclosure required for the Oil and Gas industry must be a joint project with the FASB;
- b) The existing body of US guidance for both the Minerals and the Oil and Gas industries should be carefully considered when developing any improved standards in this area and provides a great opportunity for convergence which could be achieved relatively simply;
- c) The successful-efforts approach appears to be the norm for the larger companies in Oil and Gas industry who use IFRS. We think that it is also well understood and accepted by users throughout this industry.

Finally, on the basis of the discussion in the DP, we think that it might be possible to develop a single set of disclosure requirements for the reserves and resources of the Oil and Gas and Mineral industries.

Question 3 – Definitions of minerals and oil and gas reserves and resources

In Chapter 2 the project team proposes that the mineral reserve and resource definitions established by the Committee for Mineral Reserves International Reporting Standards and the oil and gas reserve and resource definitions established by the Society of Petroleum Engineers (in conjunction with other industry bodies) should be used in an IFRS for extractive activities. Do you agree? If not, how should minerals or oil and gas reserves and resources be defined for an IFRS?

We make no judgement on whether the two organisations named above are the best in their field, but we know that they are recognised throughout their industries and therefore would provide suitable definitions of reserves and resources.

However, we think that the inclusion by reference of definitions drawn up by third parties raises the problem of the application of due process. Reserve definitions may evolve slowly, but when the organisation owning of a definition decides to change it, due process requires that the new definition be examined by the IASB and constituents and a conclusion drawn about the suitability of the changes. A rejection of the change would lead to a situation which the IASB might find difficult to resolve quickly.

For the reasons discussed in the DP, we think that it is not advisable for the IASB to develop its own definitions of reserves and resources.

Our view is, therefore, that the IASB should develop a high-level set of principles for the definitions which would make it clear to preparers and users what the minimum standard for acceptable reserve and resource definitions are. Entities would have to ensure that the definitions they use are fully compliant with this minimum.

Question 4 – Minerals or oil and gas recognition model- recognition

In Chapter 3 the project team proposes that legal rights, such as exploration rights or extraction rights, should form the basis of an asset referred to as a ‘minerals or oil and gas property’. The property is recognised when the legal rights are acquired. Information obtained from subsequent exploration and evaluation activities and development works undertaken to access the minerals or oil and gas deposit would each be treated as enhancements of the legal rights. Do you agree with this analysis for the recognition of a minerals or oil and gas property? If not, what assets should be recognised and when should they be recognised initially?

As stated in our response to Question 2 above, we think that it is important to maintain a principles-based approach to the recognition and measurement of assets. In respect of the early stages of the exploration and evaluation activity, we think that the withdrawal of IFRS 6 and application of current IFRSs and the Framework might well lead to recognition and measurement of assets in a way not very different from the accounting applied under the successful-efforts approach. There might also be a need for some interpretative guidance of the application of IAS 38 to the extractive industries.

A close examination of the current guidance and the activities carried out in the extractive industries should be the first step in assessing whether a distinct set of accounting guidance is needed. The DP undertakes this examination but then draws a conclusion about asset recognition with which we disagree.

We agree with the DP that the acquisition of the legal rights to explore for or extract minerals will generally satisfy the conditions for the recognition of an asset under the Framework and IAS 38. Such a licence gives the entity control of the prospect for a period and is valuable in as much as it can usually be sold on to another party. However, we do not agree that all subsequent expenditure on the licence property is an enhancement of that asset but think that the subsequent expenditure must be considered for its eligibility as an asset in its own right.

The DP argues that subsequent expenditure, and in particular, the obtaining of knowledge about the property, increases the value of the property and that such costs should be accumulated with those of the licence acquisition. This is partially true, but the value depends very much on the nature of the knowledge, that is whether it confirms or denies the existence of a commercially exploitable substance, rather than knowledge per se. Between general prospection and the decision to start full development and production there is a range of certainty. Somewhere along the continuum line a point is reached where it is probable that extraction is commercially feasible. We think that it is at this point that a separate asset comes into existence and costs should be capitalised. Prior to that point it is not probable that the entity will receive the future economic benefits related to the expenditure.

In our experience, most Oil and Gas entities classify exploration wells as intangible assets, thereby bringing them into the scope of IAS 38, and then classify productive wells as a component of the larger production asset within property, plant and equipment. An alternative approach of classifying exploration wells from the outset as property, plant and equipment because of their physical existence might provide another route to asset recognition. We think this could be explored further.

Question 5 – Minerals or oil and gas recognition model- unit of account

Chapter 3 also explains that selecting the unit of account for a minerals or oil and gas property involves identifying the geographical boundaries of the unit of account and the items that should be combined with other items and recognised as a single asset. The project team's view is that the geographical boundary of the unit of account would be defined initially on the basis of the exploration rights held. As exploration, evaluation and development activities take place, the unit of account would contract progressively until it becomes no greater than a single area, or group of contiguous areas, for which the legal rights are held and which is managed separately and would be expected to generate largely independent cash flows. The project team's view is that the components approach in IAS 16 Property, Plant and Equipment would apply to determine the items that should be accounted for as a single asset.

Do you agree with this being the basis for selecting the unit of account of a minerals or oil and gas property? If not, what should be the unit of account and why?

In our view, the role and definition of the unit of account is a subject which cuts across the whole of IFRS. We think that this question really needs to be first deliberated by the Board at the conceptual-framework level before being defined for individual standards or industries.

We think that existing IFRS in general, and IAS 16 and IAS 36 in particular, provides sufficient guidance for management to make judgements about appropriate groupings of components and assets based upon the facts and circumstances of individual licence areas and reserves. Further principle-based guidance could be developed for the extractive industries (and others) once the concept of the unit of account has been defined in the Framework.

Question 6 – Minerals or oil and gas asset measurement model

Chapter 4 identifies current value (such as fair value) and historical cost as potential measurement bases for minerals and oil and gas properties. The research found that, in general, users think that measuring these assets at either historical cost or current value would provide only limited relevant information. The project team’s view is that these assets should be measured at historical cost but that detailed disclosure about the entity’s minerals or oil and gas properties should be provided to enhance the relevance of the financial statements (see Chapters 5 and 6). In your view, what measurement basis should be used for minerals and oil and gas properties and why? This could include measurement bases that were not considered in the discussion paper. In your response, please explain how this measurement basis would satisfy the qualitative characteristics of useful financial information.

We agree that historical (amortised) cost is the appropriate measurement basis at initial recognition and amortised cost thereafter. This is consistent with the way non-financial items are most commonly measured under IFRS and we see no valid argument for using a different basis just for the extractive industries.

Historical cost provides users with the most relevant information as it allows them to assess the stewardship of the entity by comparing its cost-effectiveness against other industry participants. Finding costs and development costs per unit of reserves are frequently used performance indicators in these industries. In addition, return on capital employed is, in our view, more meaningful when based on a historical rather than current or fair value.

Finally, calculation of a fair value measure involves an accumulation of assumptions such that, in our view, any resulting figure is not reliable enough for the purpose of accounting measurement. It is extremely difficult to find a suitable observed market price for oil or gas fields or minerals deposits. “Headline” prices per unit are calculated by some industry watchers, but it is difficult to establish whether reserves and production facilities are of a truly comparable nature because of the unavailability of the confidential detailed data which would allow a true comparison to be made. Model-based fair value calculations are similarly unreliable because of the degree of judgement required to arrive at the assumptions used in arriving at a fair value.

We are aware of instances where partners in the same interest using the same industry-standard definitions of reserves and resources as a basis have produced estimates of quantities which vary by a factor of 2. Assumptions then have to be made about future commodity prices, future operating and investment costs, the production profile and the market discount rate. Such an accumulation of approximations is not suitable for the measurement of an asset.

Question 7 – Testing exploration properties for impairment

Chapter 4 also considers various alternatives for testing exploration properties for impairment. The project team’s view is that exploration properties should not be tested for impairment in accordance with IAS 36 Impairment of Assets. Instead, the project team recommends that an exploration property should be written down to its recoverable amount in those cases where management has enough information to make this determination. Because this information is not likely to be available for most exploration properties while exploration and evaluation activities are continuing, the project team recommends that, for those exploration properties, management should:

- (a) Write down an exploration property only when, in its judgement, there is a high likelihood that the carrying amount will not be recoverable in full; and*
- (b) Apply a separate set of indicators to assess whether its exploration properties can continue to be recognised as assets. Do you agree with the project team’s recommendations on impairment? If not, what type of impairment test do you think should apply to exploration properties?*

The consequence of the asset-continuum approach proposed in the DP is that it results in the transfer of the importance of using judgement from the initial assessment of whether an asset exists to whether there are indications of impairment at a later stage. If this approach is adopted, and as discussed above, we do not support it, then the proposed impairment approach is consistent. We do think, however, that the resulting impairment review and test will be more subjective in application than under full set of existing IFRS.

In our view, the existing impairment requirements of IFRS should be applied, in conjunction with asset recognition criteria as at present. However, some specific application guidance may be required to assist entities with the identification of acceptable methods for assessing the recoverable amount in the absence of a firm development plan. We think that this should be explored even if a major extractive activities project is not undertaken.

In respect of the oil and gas industry, we do not agree with the project team’s conclusion that all costs including the cost of drilling a successful exploration well would be written off as expense if incurred before the point where the entity has available sufficient information to determine whether the reservoir contains economically recoverable quantities of oil or gas. In practice, an entity will commit itself to an exploration well only when it has sufficient information to believe there is a reasonable probability, using the available modern assessment technology, of commercial reserves in place. The risk that the entity will accept before committing to drilling will vary, but the “successful efforts” approach of US GAAP is accepted by most major participants in the oil and gas industry and provides a pragmatic and principles-based approach to the accounting for this activity.

In our view, the decision to undertake exploratory drilling can generally be assimilated to the beginning of the development phase as it is described in IAS 38 (for example, the drilling of an exploration well can arguably be assimilated to the construction of a pilot plant). A successful exploration well is the first tangible element which allows the entity to envisage the booking of reserves. In these circumstances, it appears entirely appropriate to us to capitalise the costs of such exploratory drilling. This area provides an example of where existing IFRS requirements could be applied with the addition of interpretative guidance appropriate to the industry.

Question 8 – Disclosure objectives

In Chapter 5 the project team proposes that the disclosure objectives for extractive activities are to enable users of financial reports to evaluate:

- (a) The value attributable to an entity’s minerals or oil and gas properties;*
- (b) The contribution of those assets to current period financial performance; and*
- (c) The nature and extent of risks and uncertainties associated with those assets.*

Do you agree with those objectives for disclosure? If not, what should be the disclosure objectives for an IFRS for extractive activities and why?

We think that it is difficult to disagree with these objectives for disclosures. Indeed, similar objectives are valid for the disclosures in the financial statements of all industries and entities and we do not see why they should be restricted to the extractive activities.

As explained in the DP, the extractive industries are unique in that they have physical reserve quantities which are the keystone of the entities’ future cash flows and it is appropriate to provide users with sufficient information about those reserves to enable them to assess the companies’ future cash flows and worth. Disclosures should not be onerous to produce, nor should they try to evaluate the entity’s prospects in the place of the user.

Question 9 – Types of disclosure that would meet the disclosure objectives

Also in Chapter 5, the project team proposes that the types of information that should be disclosed include:

- (a) Quantities of proved reserves and proved plus probable reserves, with the disclosure of reserve quantities presented separately by commodity and by material geographical areas;*
- (b) The main assumptions used in estimating reserves quantities, and a sensitivity analysis;*
- (c) A reconciliation of changes in the estimate of reserves quantities from year to year;*
- (d) A current value measurement that corresponds to reserves quantities disclosed with a reconciliation of changes in the current value measurement from year to year;*
- (e) Separate identification of production revenues by commodity; and*

(f) Separate identification of the exploration, development and production cash flows for the current period and as a time series over a defined period (such as five years).

Would disclosure of this information be relevant and sufficient for users? Are there any other types of information that should be disclosed? Should this information be required to be disclosed as part of a complete set of financial statements?

In our experience, users do not place any worth on current- or fair-value measurements estimated by the entity, such as the Standardised Measure of Oil and Gas activities (SMOG) required under US GAAP. What users require is sufficient information so that they can establish their own evaluation of the entity's performance and worth. We therefore do not think that any valuations should be required.

As discussed above, in our view, current US GAAP requirements for the Oil and Gas industry provide a good indication of what is useful in this area, albeit with some exceptions. We think that the following type of information should be required:

- a) Quantities of proved reserves by commodity and major geographical area (continent or individual country where material to the entity);
- b) The main assumptions used in estimating the reserves quantities and a qualitative description of the assumptions to which the estimates are most sensitive;
- c) A reconciliation of the change in estimate of reserve quantities from the previous year-end
- d) Information about revenues and costs in the period, analysed within activity type (exploration, development and production) by continent as above, on an accruals basis. This could include revenues by commodity group.

We think that there are many uncertainties and matters of subjective judgement involved in making estimates of probable reserves and we are therefore not sure whether such disclosures are useful.

As the DP points out, the assumptions used in the estimation of reserves are crucial and those assumptions which have the greatest effect on the estimates must always be disclosed. The definitions applied in arriving at such estimates should also be disclosed.

We do not agree with the disclosure of quantitative figures for sensitivities to assumptions as there are often interactions between different assumptions when individual assumptions change. We think it would therefore be onerous for the preparer and confusing for the user if sensitivities have to be provided.

The different commodities which are extracted by the mining industry are very numerous. We believe it would be very onerous to require disclosure of the reserves of individual commodities and therefore a principle of aggregation of commodities into groups should be developed for this industry.

Finally, at present much of the information relating to reserve quantities is not required to be audited because regulators recognise that a high degree of judgement is required from specialised non-finance staff in arriving at estimates. Information about quantities is used in several areas of accounting which are subject to audit, such as, for example, depreciation charges, impairment tests of individual assets and goodwill and in the measurement of decommissioning provisions (through the estimated date of the cessation of production). Auditors generally limit their review to the controls around the estimation process and the consistency of the approaches and figures used across the entity. The question of whether disclosures of reserve estimates form part of the notes to the financial statements or are outside those notes, and therefore should be audited or not, is important as it can have consequences for the competence of the auditors and cost of the audit.

Question 10 – Publish What You Pay disclosure proposals

Chapter 6 discusses the disclosure proposals put forward by the Publish What You Pay coalition of non-governmental organisations. The project team’s research found that the disclosure of payments made to governments provides information that would be of use to capital providers in making their investment and lending decisions. It also found that providing information on some categories of payments to governments might be difficult (and costly) for some entities, depending on the type of payment and their internal information systems. In your view, is a requirement to disclose, in the notes to the financial statements, the payments made by an entity to governments on a country-by-country basis justifiable on cost-benefit grounds? In your response, please identify the benefits and the costs associated with the disclosure of payments to governments on a country-by-country basis.

The Publish What You Pay coalition has its own agenda on which we make no judgement.

We are strongly of the opinion that accounting standards should require disclosures which are consistent with the objective of general-purpose financial reporting, by providing information that is useful to investors and other capital-market participants in their decisions about providing resources. Disclosure requirements should respond to that objective, and if disclosure of certain information is determined to be necessary, then the requirement should be applicable to all entities, to the extent that they have activities or interests which are covered by the requirement. We do not think that it is appropriate to single out the extractive industries for such disclosure. Instead the Board should first define a comprehensive framework governing disclosure and identify the information which is relevant to the activities of all entities and industries.

Although we are opposed to the principle of IFRS accounting requirements driven by the agendas of outside agencies, we recognise that some of the information requested by PWYP is currently provided under existing US GAAP or on a voluntary basis by some entities. However, the detail requested goes potentially far beyond what we think is reasonable as it takes no account of the materiality of individual countries to the entity’s activities as a whole and requires breakdown of payments into individual payment types. We think that this imposes an unacceptable burden on the preparer.

We think it is the standard-setter who should determine the disclosure requirements based solely upon the objectives of financial reporting and the needs of the user. Where the disclosure of information would put the entity in breach of contractual or legal requirements, an exemption should be provided by the standard-setter. In our view, it is the role of governments to impose requirements such as many of those suggested by PWYP, if they see fit, as they have the legislative authority to do so and are better-placed to protect the entity from the consequences of compliance.

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